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October 13, 1992

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Ms. Donna R. Searcy  
Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Room 222  
Washington, D.C. 20554

RE: In the Matter of Amendment of Parts 65 and 69 of the Commission's Rules to Reform  
the Interstate Rate of Return Represcription and Enforcement Process  
CC Docket No. 92-133

Dear Ms. Searcy,

Attached are the original and five copies of the Reply Comments of the United Telephone  
Companies in the proceeding referenced above.

Sincerely,

Jay C. Keithley  
Vice President  
Law and External Affairs

Attachments

JCK/mlm

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Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

In the Matter of	)	
Amendment of Parts 65 and 69	)	
of the Commission's Rules to	)	CC Docket No. 92-133
Reform the Interstate Rate of	)	
Return Represcription and	)	
Enforcement Process	)	

**REPLY COMMENTS OF THE UNITED TELEPHONE COMPANIES**

The United Telephone companies<sup>1</sup> ("United") hereby submit their reply comments addressing issues raised by other parties in their comments concerning this Notice of Proposed Rulemaking.

In these reply comments we address our concerns with the trigger mechanism proposed by the General Services Administration ("GSA"), the GSA's proposed application of this proceeding to Price Cap carriers, and the MCI Telecommunications Corporation ("MCI") treatment of capital structure issues.

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1. Carolina Telephone and Telegraph Company; United Telephone Company of Southcentral Kansas; United Telephone Company of the Carolinas; United Telephone Company of Florida; United Telephone Company of Indiana, Inc.; United Telephone Company of Eastern Kansas; United Telephone Company of Kansas; United Telephone Company of Minnesota; United Telephone Company of Missouri; United Telephone Company of New Jersey, Inc.; United Telephone Company of the Northwest; United Telephone Company of Ohio; The United Telephone Company of Pennsylvania; United Telephone - Southeast, Inc.; United Telephone Company of Texas, Inc.; and United Telephone Company of the West.

# I. THE TRIGGER MECHANISM SHOULD NOT USE 10 YEAR TREASURY SECURITY RATES

The GSA proposed the use of 10 year Treasury "Bonds" as the basis for the represcription trigger mechanism.<sup>2</sup> United proposed the use of a public utility bond yields, as identified by Moody's, as the trigger base rate.<sup>3</sup> United asserts that the trigger mechanism should have a demonstrated similarity to common equity capital duration and a lack of volatility. The GSA proposal to use 10 year Treasury Securities fails this test.

Long term instruments, like a public utility bonds, should be the basis of the trigger. Treasury securities with a 10 year maturity are intermediate term instruments that cannot be representative of the long term capital costs of LECs. Even the U.S. Treasury does not consider 10 year Treasury securities to be long-term enough to be called "bonds." The U.S. Treasury refers to 10 year securities as "notes," thereby designating them as intermediate rather than long term in nature.<sup>4</sup> Further, intermediate term instruments have been shown to be more volatile than long term instruments.

The GSA further proposes that an annual spot assessment of the 10 year Treasury Securities be the basis of represcription

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2. GSA Comments at 8-10.

3. United Comments at 3-4.

4. The Handbook of Fixed Income Securities, 174 (F. Fabozzi, 3d ed. 1991).

trigger determinations.<sup>5</sup> A spot rate review is unsuitable for use in the trigger mechanism. Spot rate reviews would insert unacceptable volatility into the trigger mechanism. No recognition of the need to determine the persistence of changes in the spot rate, through averaging over a period of time or through adjustments for seasonal influences, is mentioned in the GSA proposal. Thus, the GSA proposal fails to meet the Commission objectives of designing a trigger mechanism that measures significant changes in capital markets that are likely to persist over time.<sup>6</sup> The GSA "spot" measure based on an intermediate term note does not meet this requirement and should be rejected.

United, USTA, and many other parties explained in detail why a moving average of long term utility bonds is the preferred alternative for a trigger mechanism. Spot rate problems and unwanted volatility are cured by the use of the long term bond yield moving average methodology.<sup>7</sup>

**II. PRICE CAP CARRIERS OPERATING  
UNDER THE FOUR YEAR PLAN ADOPTED  
IN CC DOCKET NO. 87-313 SHOULD  
NOT BE SUBJECT TO REPREScription  
DURING THE FOUR YEAR PRICE CAP PLAN**

The GSA proposes that the Commission immediately represcribe the authorized rate of return and modify the price cap sharing

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5. GSA Comments at 6-8.

6. Notice of Proposed Rulemaking ("NPRM"), CC Docket No. 92-122, Released July 14, 1992, at ¶21.

7. See United Comments at 2-4 and USTA Comments at 32-39.

mechanism to recognize a change in the prescribed rate of return.<sup>8</sup> United asserts that this proposal should be rejected.

The Commission adopted price caps for a four year period. Inherent in the plan was an 11.25 percent rate of return for the duration of the price cap trial.<sup>9</sup> The Commission clearly stated that in price caps it "adopts a new system of regulating the interstate common carrier services of the Nation's largest local exchange companies."<sup>10</sup> The Commission intended to sever the "'cost-plus' system of regulation" and replace it with "an incentive based system."<sup>11</sup>

GSA suggests that the Commission adjust the price cap plan to return to a cost-plus system. This would defeat the entire purpose of the Commission trial. Indeed, the GSA proposal does not give adequate credit to the fact that price cap regulation already takes into account changes in the United States economy through the use of the GNPPI factor. To the extent that inflation is low, and interest rates and capital costs are low, the GNPPI reflects those facts. The service rates of the price cap LECs reflect these changes in the GNPPI. End users receive

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8. GSA Comments at 3-6. See also MCI Comments at 3 where MCI suggests the Commission "might" want to consider price cap modifications.

9. In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313, Released October 4, 1990 at ¶123.

10. Id. at ¶1.

11. Id.

the benefit of a low GNPPI through its offset to the ambitious mandatory productivity factor that guarantees actual reductions in the real prices of interstate services.

Further, United voluntarily adopted the Commission price cap plan. The price cap adoption decision of United was based on the representation of the Commission that price caps would be tried for four years. Modification of that plan during the first trial period would unreasonably deprive United of the terms that were promised, and that United relied on, in good faith, in voluntarily adopting price caps.

United additionally requests that the Commission reject the GSA's claim that the 11.25 percent rate of return that the Commission approved for use during the four year price cap period should be changed. Such a change would deprive United of the terms promised under price caps, and would deprive the Commission of the opportunity to fairly evaluate the performance of price caps at the end of the four year test.

### **III. BOC DATA SHOULD BE USED IN DETERMINING CAPITAL STRUCTURE AND THE COST OF DEBT**

MCI proposes the use of Regional Holding Company data for use in capital structure and cost determinations. As an alternative, MCI proposes the use of the data of the holding companies owning Tier 1 LECs.<sup>12</sup>

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12. MCI Comments at 28-29.

United opposes the use of either Regional Holding Company data or the use of the data of Tier 1 LEC holding companies. There has been no evidence showing debt manipulation by holding companies and United believes that the risk characteristics of LECs are far different than those of their holding company parents.<sup>13</sup> United strongly urges rejection of holding company data.

#### IV. CONCLUSION

United supports the development of a represcription trigger mechanism that identifies significant and persistent changes in capital costs while minimizing unwanted volatility. The use of six month average a long term public utility bond yields, with a 150 basis point change persisting over six months, is appropriate. The GSA suggestion to use overly volatile 10 year Treasury Securities with spot assessments should not be adopted.

Further, United supports the price cap plan as originally adopted and urges the Commission to stay the course on this four year trial. Adjustments proposed by GSA should be rejected.

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13. See United Comments at 6-8 and USTA Comments at 57-63.

Finally, BOC data should be used in capital structure and cost of debt determinations and the use of holding company data should be avoided.

Respectfully submitted,

UNITED TELEPHONE COMPANIES

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October 13, 1992



**CERTIFICATE OF SERVICE**

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